

DATA REQUESTED BY STATE JOINT BOARD COMMISSIONERS

Basic Rationale for the Data Request:

The FCC has expressed a great deal of concern that some ILECs may have been using existing USF support (e.g., high-cost loop support) to pay for at least a portion of their broadband buildouts. The FCC's proposed solution, at least for wireline companies, is to repurpose federal USF mechanisms and USF support *away from* existing circuit switched networks that were designed to provide voice services but have more recently been adapted to provide DSL Internet access services, and toward IP-based networks on which "voice" would simply be one of many Internet applications. This repurposing could have significant implications for the country if it results in existing ILEC USF recipients being unable to provide either newer broadband services or traditional voice services, being unable to repay existing loans or retire other existing debt, and/or being unable to obtain additional loans or other external financing (because the lenders may perceive some ILECs as too risky, due to the loss of the repurposed USF revenue stream). Even when lenders are willing to lend to rural ILECs or mid-size companies that no longer receive federal universal service support, some of those companies may elect not to incur the debt because they, themselves, are worried about the impact on their cash flow of losing USF support and, thus, their ability to repay the loans.

Data Requested:

1. How large is the aggregate debt of all ILECs? What portion of that total has been incurred to build facilities that support broadband?

Answer – FWA does not have access to this information for all ILECs, but the aggregate long term debt for all FWA clients is \$114,951,131. This is broken down as follows:

- *RUS* *\$82,529,546*
- *CoBank* *\$18,437,500*
- *RTFC* *\$0*
- *Other Lending Institutions* *\$13,984,085*

This debt was incurred to build facilities that support basic and broadband services.

2. What is the typical ILEC debt repayment period for capital expenditure projects that involved broadband?

Answer – For FWA clients, the typical debt repayment period is between 15 and 20 years:

3. What portion of broadband borrowing is to provide broadband other than through ILECs? Are wireless carriers borrowing to provide broadband? Cable providers?

Answer – For FWA's rural ILEC clients, the long term loans are for network buildout and upgrades of ILEC networks. None of the loans shown above are for wireless or for cable operations.

4. What is the range of costs per location or per subscriber for ILEC projects that have recently been financed to provide broadband?

Answer – the cost varies significantly generally based on the density and terrain for the planned projects. Listed below are costs per subscriber for recently approved loans:

<u>Lender</u>	<u>Project Type</u>	<u>Density</u>	<u>Cost/Line</u>
RUS	Fiber to the Home	2.6 lines per square mile	\$11.3k per line
RUS	Fiber to the Home	3.2 lines per square mile	\$11.6k per line
RUS	Fiber to the Home	10.3 lines per square mile	\$6.8k per line

5. What are typical depreciation recovery periods for capital expenditure projects that involve: (a) voice and (b) broadband?

Answer – Depreciation recovery rates for network components capable of providing voice and broadband vary by state, but the typical depreciation recovery periods for the major plant categories are:

- *Central Office Switching* 10 years
- *Outside Plant including distribution* 18 years

6. How does the financial community factor in debt coverage in evaluating the financial risk of broadband deployment?

Answer – There are numerous factors, but the primary determinate is the TIER (Times Interest Earned Ratio). Essentially, this ratio determines if the ILEC will have sufficient revenues to cover, each year, the interest on its debt. In all loans involving rural ILECs, these revenues include federal universal service and intercarrier compensation revenues. If the TIER ratio is below 1, very likely the lender will not make the loan. If the TIER ratio falls below 1 after the loan is made, generally, the loan is in default.

7. What are the typical operating characteristics, if any, of ILECs which have incurred significant debt to support deployment of broadband over existing networks? What are the typical debt characteristics, if any, of ILECs that provide broadband?

Answer:

(a) Rural ILECs typically face high per-unit operating costs because of their low density and difficult and diverse terrain. See Attachment 1 for density, lines, investment and expenses/line for a number of rural ILECs.

(b) Debt for rural ILECs varies substantially and is a function of where the ILEC is in the upgrading and buildout of its network. See Attachment 1 for percent debt.

8. Among RBOC/mid-size ILEC/RLEC borrowers who have incurred debt to construct broadband, how dependent are these borrowers on current USF support mechanisms?

Answer – Not Applicable. FWA clients are all small rural ILECs.

9. What effect did the NBP have in 2010 on spending for broadband? Did it enhance or retard spending on broadband capital expenditures?

Answer – Generally, Stimulus grant/loan applications and approvals were underway by the time the NBP was published. As a consequence, we believe most carriers went through with these projects, perhaps with the hope that common sense would prevail in the universal service and intercarrier reform process and sufficient and predictable funding would be provided to make available networks to provide affordably priced basic and broadband service.

With regard to non-stimulus projects, we believe that projects were delayed and continue to be delayed. Unlike stimulus that included a grant as well as a loan, other projects that were and are entirely loans have been deferred.

10. If current USF support mechanisms are fundamentally restructured, what characteristics of the new programs are likely to make capital most available for broadband projects? How important is certainty? How important is the total amount of support?

Answer – For rural ILEC high cost to serve areas, it is critical that sufficient and predictable support revenues be provided for the recovery of actual rate-of-return network costs that are too high to be recovered through rates and services that are comparable to those offered in urban areas. Capital will be provided if these criteria are met. If sufficient and predictable support revenues are not forthcoming in a USF reform, it is unlikely that capital will be available for broadband buildout in high cost to serve areas.

11. Is it reasonable to expect that “the subsidy required may decline in the future as technology advances and costs decline?” What evidence exists to support this presumption?

Answer – With technological advances, some costs such as switching may decline. However, the majority of the costs to provide service in rural ILEC areas are distribution facilities. The labor and capital costs for distribution, where fiber is replacing copper will likely not decline. In fact, if labor costs increase, the cost of replacing or adding additional distribution will likely increase, not decrease. Additionally, the ongoing operation costs are likely to, at best, remain stable.

12. What other kinds of guidance about changes to existing regulations would help the private sector react and plan appropriately?

Answer –To help the private sector react and plan appropriately to changes in existing regulation, it is critical that the regulatory changes to not adversely affect the rural companies’ ability to pay existing loans or adversely impact future capital expenditures and ongoing maintenance of the telephone facilities. Again, sufficient and predictable support funding is critical.

13. What is the best way to quantify “the total [funding] gap for providing service in unserved areas” if the cost of supporting existing networks or replacement networks to serve existing voice and broadband customers is also taken into account, given that the FCC has acknowledged that its own estimates are likely to be significantly understated?

Answer – The majority of areas where broadband is unavailable are served by mid-sized and large ILECs. They likely are in a better position to answer this question.

14. If the FCC does repurpose existing USF support mechanisms toward broadband and/or wireless services, providers, or networks, what impact is that likely to have on small and mid-size USF recipients in the following respects:

- ☐ **Their eligibility to receive future federal USF support for telephone service?**
- ☐ **Their eligibility to receive future federal USF support for broadband services?**
- ☐ **The impact on future cash flow and, hence, their ability to repay existing loans?**
- ☐ **Lenders’ perceptions of the riskiness of these companies in the future and the lenders’ willingness to provide additional loans in the future in light of that perception of risk?**

Answer – If insufficient support is provided to allow small rural RoR ILECs to maintain, operate and continue to build out broadband capable networks, these ILECs may be eligible to receive support, but because the support is insufficient, the ILECs may not be able provide quality service and in fact may not be able to repay existing loans. See the attached analysis (Attachment 2) of the financial effect of the FCC’s proposed near term changes on a number of rural RoR ILECs. The overall regulated (interstate plus intrastate) return on line 18 is already poor because of the existing cap on the HCLF. This cap is now resulting in lower support funding each year for distribution plant costs, even though those costs are still much higher than the national average. As shown on line 28, the near term changes proposed by the FCC in the NPRM would result in negative returns and TIER ratios significantly less than 1. If these changes were implemented, these rural ILECs would likely be unable to repay their loans and may be unable to continue operations.

15. The NBP could have a chilling effect on willingness to borrow and thus on broadband build out if prospective borrowers (providers) perceive that proposed support changes would harm cash flow or increase risk. Even if loans are available, are borrowers confident that they will be able to take out and repay those loans, in light of the FCC’s proposed policy changes?

Answer: See answer to number 14.

16. Are there any lessons to be learned from the recent RUS loans provided pursuant to ARRA or other federal legislation? In particular, the NBP suggested that future FCC funding would be repurposed away from funding operating expense and debt amortization and toward funding capex directly.

For companies that were offered RUS loan funding (either a 100% loan commitment or a loan offered in combination with RUS grants), did the possible FCC policy changes affect

those companies' confidence in their ability to repay the loans? Did any potential borrowers go so far as to turn down RUS loans because of concerns that FCC changes would make them unable to repay those loans?

Answer- A few of FWA's clients did receive RUS loans and grants pursuant to ARRA that are designated for purposes of deploying additional broadband facilities (ie Fiber-to-the-home) in their regulated services areas. Since the ability to pay these RUS loans with payback terms of over 20 years was dependent on future USF support, these companies are extremely concerned that they will be not able to pay back these loans. The simple fact is that both capital expenditures and operating costs per household served are very high in rural areas due to the low population densities.

17. Assuming the FCC does begin a program of repurposing federal USF support, how likely is it that in the future, small and mid-size companies will be able to rely upon other (non-USF and non-access charge) revenues for both general operating expenses and repaying existing debt?

Answer- Because of low population density, there are limited opportunities for rural ILECS to generate additional revenues. For FWA's rural ILEC clients whom have already invested in broadband, if the current USF support was eliminated in the near future, any additional revenues from other sources will not be sufficient to repay existing loans.

18. How critical is the ability to offer video and wireless services to a company's ability to repay existing debt – particularly in the absence of USF support? What impact could factors like high video content costs have in this regard?

Answer- The ability to offer video and wireless services adds to the services that FWA's clients can bundle with their local and broadband service offering which allows the rural ILEC's to be more competitive and therefore retain more customers. However, without USF support, these rural ILECs would have great difficulty repaying existing debt, regardless of revenues from video and wireless services.

19. The FCC transition period for repurposing USF support is ten years. What is the typical amortization period for telephone company loans from different lenders such as RUS, Co-Bank, and RTFC?

Answer- Most of FWA's clients are RUS borrowers and the terms of the loans vary depending on when the funds were issued and what projects the loans were used for. Many of FWA's clients have both old RUS loans that have a 35 year term and newer RUS loans that have closer to a 15 to a 20 year term.

ATTACHMENT

ATTACHMENT 1

<u>ILEC</u>	<u>ACCESS LINES</u>	<u>DENSITY (Line per Square Mile)</u>	<u>INVESTMENT PER LINE (Gross)</u>	<u>EXPENSE PER LINE</u>	<u>% DEBT</u>
A	137	1.29	\$49,228	\$7,395	99.14%
B	984	10.26	\$8,392	\$1,962	11.49%
C	697	2.41	\$18,609	\$1,822	44.58%
D	291	3.41	\$12,188	\$1,737	0%
E	822	3.07	\$8,677	\$1,614	10.82%
F	2,345	9.23	\$7,504	\$1,782	3.35%
G	4,390	6.41	\$10,339	\$2,102	2.48%
H	11,892	2.67	\$9,610	\$1,666	16.13%
I	987	2.61	\$13,105	\$2,458	41.42%
J	1,726	2.48	\$11,149	\$2,072	44.83%
K	6,048	2.72	\$15,692	\$2,541	67.93%

ATTACHMENT 2

Analysis of USF Reform 2/9/2011 NPRM

COMPANY: AVERAGE OF ALL FWA CLIENT COMPANIES

Line	Description	Source	2010	2011	2012	2013	2014
REGULATED REVENUES							
<u>Revenues - USF Support:</u>							
LN1	NECA-ICLS	3 year forecast	\$1,216,486	\$1,242,252	\$1,276,004	\$1,324,219	\$1,391,234
LN2	NECA-LSS	3 year forecast	\$325,325	\$336,005	\$317,951	\$302,315	\$288,761
LN3	USF SNA	From USAC Appendix 1	\$71,405	\$69,625	\$47,760	\$47,760	\$18,720
LN4	USF HCL	3yr forecast and Append 1	\$781,571	\$726,056	\$631,368	\$615,102	\$587,420
LN5	SUBTOTAL -USF	=(Sum LN1 thru LN4)	\$2,394,787	\$2,373,938	\$2,273,082	\$2,289,396	\$2,286,136
LN6	1.3 Loops		3,029	2,888	2,753	2,626	2,506
LN7	Annual USF Support per Line	=(LN5 / LN6)	\$791	\$822	\$826	\$872	\$912
LN7A	Monthly USF Support per line	= (LN7/12)	\$66	\$69	\$69	\$73	\$76
<u>Other Regulated Revenues:</u>							
LN8	Other Interstate Revenues (ie. NECA settlements, Interstate Access, etc.)	Interstate Less ICLS and LSS	\$2,150,619	\$1,988,736	\$1,988,159	\$2,000,812	\$2,028,110
LN9	Other Revenue (ie Local, Intrastate Access, etc)	Total Reg Revenue Less Above	\$2,076,041	\$2,076,041	\$2,076,041	\$2,076,041	\$2,076,041
LN 10	SUBTOTAL - All other Reg. Revenues:	=(Sum LN8 + LN9)	\$4,226,661	\$4,064,777	\$4,064,201	\$4,076,854	\$4,104,151
LN 11	<u>TOTAL REGULATED REVENUES</u>	=(LN7 + LN10)	\$6,621,448	\$6,438,715	\$6,337,283	\$6,366,249	\$6,390,287
<u>Regulated Operating Expense, Interest, Other:</u>							
LN12	Op. Expense	From Forecast	\$5,703,379	\$5,790,086	\$5,776,580	\$5,820,671	\$5,862,406
LN13	Interest	From Forecast	\$496,309	\$500,335	\$548,677	\$542,240	\$509,501
LN14	Other	All Other Income Stmt Items	\$10,657	\$2,329	\$12,364	\$6,506	\$3,423
LN15	TOTAL OPERATING EXPENSE, INTEREST, ETC	=(Sum LN12 + LN14)	\$6,210,345	\$6,292,750	\$6,337,621	\$6,369,417	\$6,375,331
Line	Description	Source	2010	2011	2012	2013	2014
LN16	Net Income Before Tax	=(LN11 - LN15)	\$411,103	\$145,965	(\$338)	(\$3,167)	\$14,957

LN 17	Net Investment	3 Year Forecast	\$11,068,044	\$11,334,560	\$11,487,021	\$12,014,263	\$13,079,552
LN 18	ROR	=(LN16 / LN17)	3.71%	1.29%	0.00%	-0.03%	0.11%
LN 18a	HCL Cap Revenue Effect	From Forecast			(\$80,213)	(\$218,469)	(\$360,362)
LN 19	TIER	=((LN13+LN16)/LN13)	1.8283	1.2917	0.9994	0.9942	1.0294
NPRM Impacts					2012	2013	2014
LN 20	High Cost Loop Fund				(\$20,097)	(\$27,373)	(\$20,766)
LN 21	Safety Net Additive				(\$22,635)	(\$41,717)	(\$36,508)
LN 22	LSS				(\$119,340)	(\$242,296)	(\$361,636)
LN 23	ICLS				(\$55,710)	(\$113,108)	(\$168,818)
LN 24	\$3000/Ln Support Limitation	= Compare to Line 7			(\$64,888)	(\$45,169)	(\$20,611)
LN 25	Total Support Reduction	=(Sum LN20 thru LN24)			(\$282,669)	(\$469,664)	(\$608,340)
LN 25A	Total Monthly Support Reduction Per Line	=(Line 25 / Line 6 / 12)			(\$9)	(\$15)	(\$20)
LN 26	Estimated USF Support to be received if current NPRM is implemented:				\$1,990,413	\$1,819,732	\$1,677,796
LN 27	Modified Net Income	=(LN16 + LN25)			(\$283,007)	(\$472,832)	(\$593,383)
LN 28	Modified ROR	=(LN28 / LN 17)			-2.46%	-3.94%	-4.54%
LN 29	Modified TIER	=((LN13+LN27)/LN13)			0.4842	0.1280	-0.1646